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No. 05-

IN THE

Supreme Court of the United States

MCLANE WESTERN, INC.,
Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF COLORADO, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the Colorado Court of Appeals, Division IV

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Does a state tax on activities related to the distribution of a product in the State, which increases because more stages in the distribution chain are located outside the State rather than within the State, impermissibly discriminate against interstate commerce?

PARTIES TO THE PROCEEDING

In addition to the parties listed in the caption, respondents include M. Michael Cooke, sued in her official capacity as the Executive Director of the Department of Revenue of the State of Colorado.

Fred Fisher, former Executive Director of the Department of Revenue of the State of Colorado, was sued in his official capacity in petitioner's initial complaints, but was substituted upon retirement prior to the judgments below.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

McLane Western, Inc. is a wholly-owned subsidiary of McLane Company, Inc. McLane Company, Inc. is a wholly-owned subsidiary of Berkshire Hathaway Inc., a publicly-traded company. McLane Western, Inc. has no subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner McLane Western, Inc. ("McLane") respectfully petitions for a writ of certiorari to review the judgment of the Colorado Court of Appeals, Division IV, in this case.

OPINIONS BELOW

The opinion of the Colorado Court of Appeals (App., *infra*, 1a-13a) is reported at 126 P.3d 211. The opinions and orders of the District Court, City and County of Denver, Colorado, entering summary judgment for respondents (App., *infra*, 14a-24a) and denying McLane's motion to alter or amend judgment (*id.* at 25a) are not officially reported. The Colorado Supreme Court's denial of McLane's petition for a writ of certiorari (*id.* at 26a-27a) is not officially reported.

JURISDICTION

The judgment of the Colorado Court of Appeals was entered on May 5, 2005. *Id.* at 1a-13a. The Colorado Supreme Court denied McLane's petition for a writ of certiorari on January 9, 2006. *Id.* at 26a-27a. The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const., art. I, § 8, cl. 3, provides, in relevant part: "The Congress shall have Power * * * [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Relevant portions of the Colorado statutes, Colo. Rev. Stat. §§ 39-28.5-101 and 39-28.5-102 (1986), are set forth at App., *infra*, 28a-29a.

STATEMENT OF THE CASE

This case involves the constitutionality of a Colorado excise tax on activities related to the distribution of tobacco products in the State. The State imposes the tax on the initial distribution activity that occurs in Colorado. The tax base is the price paid for the product by the distributor who "first receives" (Colo. Rev. Stat. § 39-28.5-101(2)) the product in Colorado (the "first Colorado distributor"). A tax rate of 20 percent was applied to this base during the relevant time period. Because the price of the product increases as it moves through the distribution network, which includes manufacturing, packaging, transportation, and marketing, the tax base is necessarily lower when all the steps in the distribution network are performed by entities located within the State. By the same token, the tax base is necessarily higher when more steps in the distribution network are performed by entities located outside the State because the price paid by the first Colorado distributor will include the mark-ups reflecting the out-of-state distribution activities.

The court below recognized that "the tax base will be higher the later in the distribution network the product is taxed" (App., *infra*, 6a), and that the determination of the tax base therefore may place petitioner "at a competitive disadvantage in the marketplace[.]" *Id.* at 8a. But the court rejected the claim that an increase in the tax base attributable to the out-of-state location of more steps in the distribution chain violated the Commerce Clause, because it believed that none of this Court's precedents "involves a determination that a state tax violates the Commerce Clause based on the inequities of a shifting tax base." *Id.* at 10a.

The far-reaching question raised by this case is whether Colorado's taxing regime, whose "shifting tax base" rewards the location of economic activity in Colorado and penalizes the location of economic activity in other States, discriminates against interstate commerce in violation of the Commerce Clause.

1. Factual Background

a. Colorado imposes an excise tax on "the sale, use, consumption, handling, or distribution" in the State of all tobacco products other than cigarettes. Colo. Rev. Stat. § 39-28.5-102(1). The tax is imposed upon the first taxable event that occurs in Colorado. The tax is collected from the first Colorado distributor, *i.e.*, the person in the distribution chain who "first receives" (Colo. Rev. Stat. § 39-28.5-101(2)) the product in Colorado when the first taxable event occurs.[1] *Ibid.*; Colo. Rev. Stat. § 39-28.5-102.

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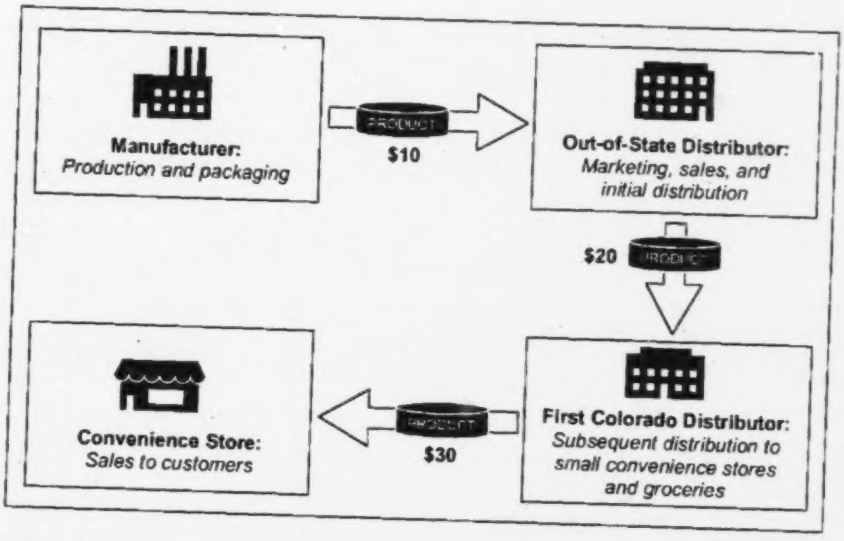
[1] The statute provides alternative events that may identify the first Colorado distributor (and therefore the tax base), including where there is in-state manufacturing or where an in-state retailer receives product from outside the State. Colo. Rev. Stat. § 39-28.5-102(1)(a)-(c). To the extent these alternatives are relevant to this case, they reinforce the discrimination against interstate commerce since they all involve the first in-state

During the time at issue in this case, the tax was imposed at the rate of 20 percent—it has since increased to 40 percent[2]—of the price paid by the first Colorado distributor for the product regardless of the point in the distribution chain at which the first Colorado distributor receives the product. Thus, where significant parts of the chain, *i.e.*, manufacturing, packaging, transportation, and marketing, take place outside the State, the tax is imposed on a price that is much greater than when the entire chain of distribution activity occurs within the State, because in the former situation the price reflects mark-ups at the various steps in the distribution chain whereas in the latter it does not. The base on which the tax is imposed in the latter situation is much lower because that base is the price paid at the first step in the distribution chain following manufacture and before mark-ups that occur further down the chain.

The distribution chain and the increasing tax base may be illustrated as follows:



activity of the distribution chain, regardless of how much the price of the product may have been marked-up outside the State. *Ibid.*

[2] Colo. Rev. Stat. § 39-28.5-102.5 (2005) (additional 20 percent tax levy).

b. Petitioner McLane buys, resells, and ships grocery products from large suppliers to smaller retailers throughout the western United States, including Colorado. App., *infra*, 1a-2a, 15a-16a. Among the products McLane buys and resells are smokeless tobacco products that are subject to the Colorado excise tax. During tax periods spanning March 1990 to December 2001, McLane bought these products from a distributor located outside of Colorado. *Id.* at 2a, 16a-18a. The out-of-state distributor shipped the products by common carrier to McLane's warehouse in Colorado. *Id.* at 2a, 17a-18a. During that time period, McLane paid its out-of-state supplier approximately $95 million for such products. *Id.* at 17a. McLane inspected and accepted or rejected the products at its Colorado warehouse and then resold the products in Colorado to its customers, primarily grocery and small convenience stores. *Id.* at 1a-2a, 16a-18a. Because McLane was the first in-state recipient of the products, *i.e.*, the first Colorado distributor, it was liable for payment of the excise tax.

During the tax periods at issue, McLane paid excise taxes to Colorado of approximately $19 million—20 percent of the $95 million that it paid for the products. *Id.* at 17a. McLane subsequently determined that Commerce Clause considerations (and a proper reading of the state statute) compelled the conclusion that the proper base for the excise tax was the price of the product at the beginning of the distribution network (approximately $42.5 million) rather than the $95 million marked-up price it had paid at the end of the distribution network. Accordingly, McLane recalculated the proper tax due as 20 percent of the lower base of $42.5 million, or approximately $8.5 million. After accounting for a small vendor deduction, McLane filed refund claims with the Colorado Department of Revenue for approximately $10 million (plus statutory interest), which reflects the difference between the $19 million paid and the $8.5 million that should have been paid. *Id.* at 3a, 17a-18a. McLane's refund claims

explicitly rested on the ground, among others, that the use of the marked-up price as the base to determine its excise tax liability discriminated against interstate commerce in violation of the Commerce Clause. The Department denied McLane's refund claims. *Id.* at 3a, 18a.

2. The Proceedings Below

McLane filed suit in the District Court, City and County of Denver, Colorado, against the Department of Revenue for refund of the excise taxes and statutory interest. McLane alleged, among other things, that the use of an excise tax base measured by the marked-up price McLane paid for the products—rather than their lower price at the beginning of the distribution network—discriminated against interstate commerce in violation of the Commerce Clause, because it disadvantages businesses whose distribution chains include significant steps outside of Colorado as compared to businesses whose entire distribution chain is located within the State.

The district court entered summary judgment for the Department. *Id.* at 14a-24a. The court rejected McLane's argument that a proper construction of the state statute required that the base for the tax be measured by the price of the product at the beginning of the distribution network. The court also dismissed McLane's Commerce Clause objections to this interpretation of the statute (*id.* at 23a-24a), but did so based on its view that "[t]he tax base for McLane would be the same" regardless of where business was done (*id.* at 24a), a view later rejected by the court of appeals. *Id.* at 6a.

The court of appeals affirmed. *Id.* at 1a-13a. The court rejected the district court's view that McLane's tax base would be the same regardless of how much of the distribution network was located in Colorado (*id.* at 6a) and, instead, expressly recognized that the excise tax creates a "shifting tax base." *Id.* at 10a. The court nevertheless agreed with the district court that the statute required that McLane pay the tax

based on the marked-up price it paid for the product. *Id.* at 6a, 8a, 12a-13a. Consequently, the court of appeals squarely confronted the fundamental constitutional question raised by this case:

> Whether a tax on a "shifting tax base" (*id.* at 10a)—namely, a tax base that will "be at its lowest level" when "the manufacturers, suppliers, or distributors involved in the product's distribution network" are "located within Colorado" (*id.* at 6a)—discriminates against interstate commerce in violation of the Commerce Clause.

The court recognized that this Court's Commerce Clause jurisprudence condemns as unconstitutionally discriminatory a levy that either "taxes out-of-state transactions or entities at a rate higher than it taxes in-state transactions, entities, or products," or "exempts in-state transactions, entities, or products from an otherwise uniform tax." *Id.* at 7a. In the court's view, however, any discrimination that falls outside the precise confines of these specific prohibitions is not cognizable under the Commerce Clause.

The court acknowledged that "the location of the manufacturers, suppliers, or distributors involved in the product's distribution network and the price mark-up of each impacts the tax base or the price upon which the constant twenty percent tax rate is imposed." *Id.* at 6a. Even more to the point, the court acknowledged that "if the manufacturer and all the distributors were located within Colorado, the tax base would be at its lowest." *Ibid.* Nonetheless, the demands of the Commerce Clause were satisfied, according to the court, as long as "[a]ll taxable distributors * * * are taxed at the same rate and on a tax base determined in the same fashion." *Id.* at 8a. The court was unfazed by the discrimination that lies at the heart of this case—the discrimination created by a shifting base on which the tax is imposed—because of the purported lack of a precedent involving "a determination that a state tax violates the Commerce Clause based on the inequities of a

shifting tax base." *Id.* at 10a. Thus, even though the Colorado excise tax imposes a higher tax when more steps in the distribution process occur outside the State, and even though (as the court conceded) this "may place the product at a competitive disadvantage in the marketplace because the higher tax is added to the price" (*id.* at 8a), this was insufficient in the court's view to "render the tax unconstitutional under the Commerce Clause." *Ibid.*

The Colorado Supreme Court denied McLane's petition for a writ of certiorari. *Id.* at 26a-27a.

REASONS FOR GRANTING THE PETITION

The decision of the Colorado Court of Appeals warrants review by this Court for two compelling reasons. First, the court of appeals' determination that the Commerce Clause is not violated by an excise tax that increases when more links in a distribution chain are located outside the State and is at its lowest when all the links in the chain are located within the State is in profound tension with this Court's precedents barring discrimination against interstate commerce "whether forthright or ingenious." *Best & Co. v. Maxwell*, 311 U.S. 454, 455 (1940). By sustaining a tax that admittedly creates "a competitive disadvantage in the marketplace" (App., *infra*, 8a) when a product's distribution network lies outside the State, the court throws into question bedrock Commerce Clause doctrine barring discrimination against products and activities that cross state lines.

Second, the Colorado Court of Appeals' decision, if allowed to stand, would provide a template for States to discriminate against interstate commerce by the simple expedient of effectuating such discrimination through a shifting tax base rather than through the more forthright forms of discrimination that courts routinely condemn as unconstitutionally discriminatory under the Commerce Clause. For example, tax exemptions or credits for in-state products—

quintessential violations of settled dormant Commerce Clause doctrine (*see, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (exemption); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (credit))—would pass muster if reconfigured as unobjectionable "inequities of a shifting tax base." App., *infra*, 10a. A "tax base" exception to the Court's prohibition against discriminatory state taxation would therefore open a gaping hole in the constitutional structure that protects interstate commerce from unconstitutionally burdensome state taxes. The extraordinary implications of such a rule require review by this Court.

I. THE STATE COURT'S APPROVAL OF A STATE EXCISE TAX THAT IS GREATER WHEN MORE STEPS IN A DISTRIBUTION CHAIN OCCUR OUTSIDE THE STATE CONFLICTS WITH THIS COURT'S COMMERCE CLAUSE JURISPRUDENCE

"Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate 'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'" *Granholm v. Heald*, 125 S. Ct. 1885, 1895 (2005) (quoting *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 511 U.S. 93, 99 (1994)). Taxes discriminating against interstate commerce fall squarely within this prohibition. *See, e.g., South Cent. Bell Tel. Co. v. Alabama*, 526 U.S. 160 (1999); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996). And so does Colorado's tobacco excise tax.

The disparate treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter is undisputed in this case. The tax at issue was measured by the marked-up price McLane paid when it received the product in the State as the first Colorado distributor. The tax would have been substantially less if "the manufacturers,

suppliers, or distributors involved in the product's distribution network" had been "located within Colorado," because the tax would apply before the price mark-ups occurred, and "the tax base would be at its lowest level." App., *infra*, 6a. For the same reason, when the distribution network is located outside of Colorado, as in the instant case, the tax will be greater, because the tax applies after the mark-ups reflecting out-of-state activity occur. Simply put, as the court below recognized, "the tax base will be higher the later in the distribution network the product is taxed[.]" *Ibid.* The lower tax borne by the product when the distribution network is entirely in Colorado, and the higher tax borne by the product when the distribution network is outside Colorado, inescapably constitutes the "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter" that violates the Commerce Clause. *Granholm*, 125 S. Ct. at 1895.

The contrary ruling by the Colorado Court of Appeals warrants review because it conflicts with well-established precedent of this Court.

A. The Ruling Below Is Contrary To *Halliburton*

In *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963), this Court struck down a state tax on the ground that a shifting tax base, analogous to the Colorado tax base at issue here, discriminated against interstate commerce in violation of the Commerce Clause. *Halliburton* involved Louisiana's sales and use tax regime, whose purpose was "to make all tangible property used or consumed in the State subject to a uniform tax burden irrespective of whether it is acquired within the State, making it subject to the sales tax, or from without the State, making it subject to a use tax at the same rate." *Id.* at 66. The tax base of Louisiana's sales and use tax regime was the "sales price" of items sold in the State

and the "cost price" of articles sold outside the State, but used within the State.

The State defined the "cost price" tax base, however, as the actual cost of the articles brought into the State without any deduction for labor. Therefore, when the taxpayer, after acquiring materials in Oklahoma and assembling them there into specialized equipment, brought the assembled equipment into Louisiana for use in its business of servicing oil wells, Louisiana assessed a two percent use tax on the "cost price" tax base of the equipment. The "cost price" tax base was the purchase price of the materials plus the value added in Oklahoma by the taxpayer's labor in assembling the equipment. By contrast, if the taxpayer had acquired the materials in Louisiana and assembled them there, it would have paid a two percent sales tax on the "sales price" tax base of the equipment, but would not have paid a tax on its labor costs.

The Court struck down the tax on the ground that the shifting tax base discriminated against interstate commerce. Although the rate of tax was the same regardless of where the taxpayer assembled or used its equipment, the differential treatment that burdened the out-of-state economic interests and benefited the in-state interests was apparent. The Court observed that the out-of-state manufacturer's "*tax base* is *increased* through the inclusion of its product's labor and shop overhead," because it had occurred out of State, *id.* at 70 (emphasis added), and that *increase* in the tax base attributable to out-of-state activity was a source of discrimination that led the Court to invalidate the tax because of the "resulting tax inequality." *Id.* at 71.

The analogy between *Halliburton* and the instant case could hardly be closer. In both cases, the state statute imposed a tax on various related taxable events (sale, use, *etc.*). In both cases, the tax was imposed on the first taxable event that occurred within the State. In both cases, the measure of the tax was the price of tangible personal property. And in both

cases, the tax base increased as more economic activity occurred outside the State and decreased as more economic activity occurred inside the State.

Thus, in *Halliburton*, the tax base increased because assembly activity occurred outside Louisiana, just as in the instant case the tax base increases because distribution activity occurs outside Colorado. Similarly, in *Halliburton*, the tax base decreased when assembly activity occurred in Louisiana, just as in the instant case the tax base decreases when distribution activity occurs in Colorado. In both cases, the source of the unconstitutional discrimination is the increase in the tax base attributable to the mark-up of the property's price to reflect the out-of-state activity. When that out-of-state activity occurs in the State, the tax base is lower because the tax is triggered at an earlier point in the distribution process, before the value-adding activities reflected in the marked-up price of the property have occurred. As a matter of substance, *Halliburton* and the instant case are identical twins, and if one of them is good law the other cannot be.

Halliburton remains bedrock Commerce Clause doctrine. *Granholm*, 125 S. Ct. at 1897 (citing *Halliburton*); *Fulton*, 516 U.S. at 333 n.3 (same); *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 192 n.6 (1995) (same); *Associated Indus. of Mo. v. Lohman*, 511 U.S. 641, 648 (1994) (same); *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin.*, 505 U.S. 71, 78 (1992) (same); *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 385 (1991) (same). For example, in *Amerada Hess Corp. v. Director, Division of Taxation*, 490 U.S. 66 (1989), the Court reiterated the fundamental proposition that States may not create taxing regimes that induce businesses to ply their trade within a State rather than in interstate commerce, and cited *Halliburton*, observing that the "Louisiana statute had the discriminatory effect of imposing a greater tax on the same

goods if they were manufactured outside Louisiana than if they were manufactured within the State, thereby creating an incentive to locate the manufacturing process within the State." *Id.* at 76. The same point applies here with respect to the location of the distribution chain in Colorado. *See also Fulton*, 516 U.S. at 327 (invalidating as unconstitutionally discriminatory under the Commerce Clause a state intangible property tax on corporate stock that varied inversely with the corporation's economic activity in the State); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 401 (1984) (invalidating as unconstitutionally discriminatory a tax credit scheme that "penalizes increases in * * * activities in other States").

The State of Colorado is not, of course, left without a means of imposing an evenhanded excise tax. Constitutionally permissible excise taxes are imposed on a tax base that does not change depending on whether economic activity occurs within or without the State. For example, a constitutional excise tax may be imposed on the number of units of a product brought into the State, such as gallons of gasoline. Colo. Rev. Stat. § 39-27-102(1)(a)(II)(A) (levying gasoline tax of 20 cents per gallon). Similarly, there can be no constitutional objection to an excise tax imposed on the value of a product at a particular point in the distribution chain (manufacture, wholesale, or retail) as long as the point in the chain at which the tax is imposed does not vary depending upon whether the distribution chain itself is located within the State. Colo. Rev. Stat. § 39-26-104(1)(a) (levying sales tax on retail sales price).

B. The Court Of Appeals' Cramped Reading Of This Court's Commerce Clause Precedent Should Not Be Allowed To Stand

The Colorado Court of Appeals' dismissal of McLane's Commerce Clause claim for want of a controlling "shifting tax base" precedent was misguided for two reasons. First, as

we have already demonstrated, there *is* such a precedent on point, namely *Halliburton*. Second, the state tax discrimination here offends core Commerce Clause principles.

Significantly, the court of appeals did not contest the underlying Commerce Clause logic of petitioner's argument, namely, that the State's tax base increased when more of the distribution chain was located outside of Colorado and decreased as more of the distribution chain was located in Colorado. To the contrary, the court embraced it. Thus the court explicitly conceded that "the tax base calculated on the price paid by the taxable distributor may place the product [from outside the State] at a competitive disadvantage in the marketplace because the higher tax is added to the price[.]" App., *infra*, 8a. What led the court of appeals to uphold this "competitive disadvantage" against constitutional challenge was not a failure of logic, but rather the purported absence of a precedent on point.

But this Court has made clear in one way or another on countless occasions that the Commerce Clause forbids state tax discrimination regardless of the form that it takes or the statutory mechanism that produces it. The Court has declared that "[a]ctual discrimination, wherever it is found, is impermissible." *Associated Indus.*, 511 U.S. at 650. The Court has expressly "declined to attach any constitutional significance to * * * formal distinctions that lack economic substance" in evaluating claims of state tax discrimination. *Westinghouse*, 466 U.S. at 405. It has long been established that "'[t]he commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce.'" *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 201 (1994) (quoting *Best*, 311 U.S. at 455-456). In short, a state tax regime favoring in-state over out-of-state economic interests violates the Commerce Clause

regardless of whether the source of the discrimination lies in the rate, an exemption, a credit, or the base.

The court of appeals' failure to reconcile its decision with *Halliburton*, its focus on the form rather than the substance of the discrimination at issue here, and its unwarranted reliance on a purported "shifting tax base" exception to the non-discrimination principle of the dormant Commerce Clause in the face of a tax regime that admittedly creates a "competitive disadvantage" for products that cross state lines (App., *infra*, 6a, 8a, 10a), underscore the need for this Court's review. Left unreviewed, the court's cramped analysis stands as precedent that unduly narrows this Court's Commerce Clause jurisprudence and ignores the fact that the prohibition against state tax discrimination requires an analysis of the practical effect of the challenged scheme.[3]

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[3] This Court currently is considering in *DaimlerChrysler Corp. v. Cuno*, 386 F.3d 738 (6th Cir. 2004), *cert. granted*, 126 S. Ct. 36 (2005) (No. 04-1704), and *Wilkins v. Cuno*, 386 F.3d 738 (6th Cir. 2004), *cert. granted*, 126 S. Ct. 36 (2005) (No. 04-1724), a challenge to a tax incentive that allegedly violates the Commerce Clause by rewarding a taxpayer for locating activities within the State. Regardless of how the Court resolves the questions in those cases, which include standing as well as substantive Commerce Clause issues, this case is distinguishable in two essential respects: first, petitioner clearly has been harmed by the Colorado tax (with more than $10 million of tax liability in dispute); second, there clearly is a burden on interstate commerce because the tax increases when more steps in the distribution chain are located outside, rather than within, the taxing State.

II. IF LEFT UNREVIEWED, THE DECISION BELOW WILL SERIOUSLY UNDERMINE COMMERCE CLAUSE RESTRAINTS ON DISCRIMINATORY STATE TAXES IN CONTEXTS WELL BEYOND THE FACTS OF THIS PARTICULAR CASE

The flawed ruling by the Colorado Court of Appeals has extraordinary practical implications. If left unreviewed, the court of appeals' decision will provide a simple formula for state legislatures to enact discriminatory state taxes that will be immune from challenge and will thereby seriously undermine long-standing Commerce Clause restraints on taxes favoring in-state over out-of-state economic interests.

A. The Ruling Below Would Allow State Taxing Authorities Easily To Transform Otherwise Unconstitutional Taxes Into Permissible Tax Schemes That Discriminate Against Interstate Commerce

The practical implications of leaving undisturbed the court of appeals' decision are considerable. First, it is a fairly easy task to transform a tax that unconstitutionally discriminates against interstate commerce on familiar grounds of rate (*see, e.g., Associated Industries*, 511 U.S. 641), exemption (*see, e.g., Bacchus Imports*, 468 U.S. 263), or credit (*see, e.g., New Energy*, 486 U.S. 269), into a tax that discriminates on the ground of base. Consider, for example, *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984).

In *Armco*, the Court reviewed a West Virginia gross receipts tax imposed on various business activities in the State, including manufacturing and wholesaling. In-state manufacturers, however, were exempted from the tax on wholesaling. The Court struck down the exemption as unconstitutionally discriminatory. The Court reemphasized its long-standing doctrine that "a State may not tax a transaction

or incident more heavily when it crosses state lines than when it occurs entirely within the State." *Id.* at 642. The Court then noted that the challenged tax had "just this effect":

> The tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it. Thus, if the property was manufactured in the State, no tax on the sale is imposed. If the property was manufactured out of the State and imported for sale, a tax of 0.27% is imposed on the sale price.

Id. The Court went on to hold that the imposition of a higher in-state manufacturing tax did not eliminate the unconstitutional discrimination because the two taxes were not appropriate compensating taxes and when the two taxes were considered together, "discrimination against interstate commerce persist[ed]." *Id.* at 644.

But now assume that discrimination caused by a shifting tax base (such as Colorado's) that increases when economic activity occurs outside the State is constitutionally tolerable. West Virginia could now reenact its gross receipts tax, imposing it, as before, on both manufacturing and wholesaling, but without any exemption for manufacturers from the wholesaling tax, consistent with the Court's ruling. And, West Virginia could then achieve a comparable result as before if, like Colorado in the instant case, it imposed the tax only on the first taxable event in the State, whether that event is manufacturing or wholesaling. If a West Virginia manufacturer paid a West Virginia manufacturing tax on a "base" of $100 and sold the property in West Virginia for $200, it would owe no tax on the $200 wholesale sale, because it had already paid a tax to the State on the first taxable event (manufacturing). By contrast, an out-of-state manufacturer who sold property in West Virginia would pay a tax on a "base" of the $200 wholesale sale, because it would be the

first taxable event in the State. Although from an economic standpoint this is precisely the same tax discrimination that the Court struck down in *Armco*, it would survive scrutiny under the court of appeals' analysis because the discrimination is the function of a "shifting tax base"—a $100 base for the in-state manufacturer and a $200 base for the out-of-state manufacturer. As a matter of substance, of course, West Virginia would have simply exempted the in-state manufacturer from the wholesaling tax, which is precisely what *Armco* condemned as unconstitutional in another form. If the "practical or economic effect of the tax" (*Goldberg v. Sweet*, 488 U.S. 252, 262 (1989)), rather than "'magic words or labels'" (*Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992) (quoting *Railway Express Agency, Inc. v. Virginia*, 358 U.S. 434, 441 (1959))), is to be the touchstone of Commerce Clause inquiry, the Colorado Court of Appeals' analysis cannot stand.

B. Permissible Discrimination Against Interstate Commerce By State Tax Schemes Would Have Real And Adverse Consequences For Our National Common Market

It is not just the ease with which the "shifting tax base" theory adopted by the court of appeals allows States to avoid the strictures of the dormant Commerce Clause that should be cause for concern. It is also, and in the end, more importantly, the consequences of this statutory legerdemain. This Court described those consequences in the very "shifting tax base" case to which we have already alluded, *Halliburton*. There the Court pointed out just what would happen if States could adopt taxes with bases (like the Colorado tax challenged here) that include the value of out-of-state but not equivalent in-state economic activity. *Halliburton*, 373 U.S. at 72-73.

First, even if only a single State were to impose "an additional tax burden for such out-of-state operations, the

disparate treatment would be an incentive to locate within" that State, and it would tend "'to neutralize advantages belonging to the place of origin.'" *Id.* at 72 (citation omitted). Of course, this Court's tax discrimination cases implicitly disapprove of such a result because a tax that is "'discriminatory in favor of the local merchant'" (*ibid.* (citation omitted)), encourages the out-of-state operator to move business into the State "in order to compete on equal terms." *Ibid.* In short, if the cost of out-of-state activities, but not equivalent in-state activities, is included in a State's "shifting tax base," there would be "an inexorable hydraulic pressure on interstate businesses to ply their trade within the State that enacted the measure rather than 'among the several States.'" *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 286-287 (1987) (citation omitted).

Second, as this Court further observed in *Halliburton*, if other States adopted similar unequal tax structures—"a not unlikely result" if this Court were to affirm such a scheme—"the effects would be more widespread." *Halliburton*, 373 U.S. at 72. As *Halliburton* explained, "[t]he economic advantages of a single assembly plant" for multistate activities "would be decreased for units sent to every State other than the State of residence. At best, this would encourage the [taxpayer] to locate his assembly operations in the State of largest use for the units. At worst, it would encourage their actual fractionalization or discontinuance. Clearly, approval of [such a tax] would 'invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause.'" *Id.* at 72-73 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 356 (1951)).

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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April 7, 2006

APPENDIX

APPENDIX A

COLORADO COURT OF APPEALS
DIV. IV

No. 03CA2471

MCLANE WESTERN, INC.,
Plaintiff-Appellant,

v.

DEPARTMENT OF REVENUE OF THE STATE OF COLORADO; and M. MICHAEL COOKE, as the Executive Director of the Department of Revenue of the State of Colorado,
Defendants-Appellees.

May 5, 2005.
Certiorari Denied Jan. 9, 2006.

ROY, J.

Plaintiff, McLane Western, Inc., appeals the trial court's summary judgment in favor of defendants, the Department of Revenue of the State of Colorado and M. Michael Cooke, its Executive Director (collectively, the Department). We affirm.

The sole issue presented in this case is whether the excise tax imposed by Colorado on "the sale, use, consumption, handling, or distribution" of certain tobacco products in the state, § 39-28.5-102, C.R.S.2004, violates the Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3. We conclude that it does not.

McLane buys, resells, and ships grocery products throughout the State of Colorado and other western states from its headquarters in Longmont, Colorado. As part of its opera-

tions, McLane buys tobacco products other than cigarettes, commonly referred to as "other tobacco products" (OTP), from manufacturers and suppliers and then resells them to its customers, primarily grocery and small convenience stores.

Prior to 1990, as relevant here, McLane purchased OTP directly from the United States Tobacco Company (U.S.T. Co.). U.S.T. Co. manufactured, marketed, and sold its products to unaffiliated distributors.

In 1990, U.S.T. Co. reorganized and formed two wholly-owned subsidiaries, United States Smokeless Tobacco Manufacturing, L.P. (Manufacturing) and United States Smokeless Tobacco Brands, Inc. (Sales). U.S.T. Co. also changed its name to United States Smokeless Tobacco Company (Smokeless Tobacco). After the reorganization, Manufacturing was responsible for manufacturing and packaging the products, and Sales was responsible for marketing and sales.

After Smokeless Tobacco reorganized and renamed itself, McLane purchased OTP from Sales. Sales purchased the OTP from Manufacturing at an invoice price that did not include any discounts or other reductions. Sales then resold the OTP at a higher price to McLane. According to Sales, this higher price reflected its own operating costs, profit margin, and the added value that came from its sales, marketing, distribution, and advertising efforts.

Manufacturing and Sales are located outside of Colorado, and the sale of OTP between them occurred outside of Colorado. McLane orders OTP from Sales, which ships the product to McLane in the state by common carrier. Upon the arrival at McLane's warehouse, McLane inspects and accepts or rejects the product.

McLane seeks refunds pursuant to § 39-28.5-101, *et seq.*, C.R.S.2004, of what it asserts were excess OTP excise taxes paid during various periods between 1990 and 2001. The OTP excise tax rate is twenty percent, which the Department

has assessed based on the manufacturer's or supplier's price paid by McLane to Sales.

McLane filed claims with the Department seeking a refund based upon its recalculation of the tax based on the price paid by Sales to Manufacturing, not on the higher price it paid to Sales. Using this recalculation, McLane claims a tax refund in the amount of $10,163,024.33 plus statutory interest. The Department denied the requests, and McLane commenced two actions, which have been consolidated. After agreeing to the material facts, the parties submitted cross-motions for summary judgment. The trial court granted the Department's motion. This appeal followed.

At the outset, we note that the parties have agreed that the price paid by Sales to Manufacturing meets the definition of "manufacturer's list price" as that term is defined by the applicable statute, § 39-28.5-101(3), C.R.S.2004. However, we recognize that in other contexts affiliated entities are considered a single economic entity. *See Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 104 S.Ct. 2731, 81 L.Ed.2d 628 (1984)(affiliated entities cannot conspire for antitrust purposes because they are parts of a single entity); *Sec. Tire & Rubber Co. v. Gates Rubber Co.*, 598 F.2d 962 (5th Cir.1979) (Robinson-Patman Act price discrimination); *see also United States Tobacco Sales & Mktg. Co. v. State*, 96 Wash.App. 932, 982 P.2d 652 (1999) (price paid by Sales to Manufacturing may not reflect "fair market value" of promotional samples distributed by Sales for the purposes of OTP tax). We are, nonetheless, bound by the agreement of the parties.

Section 39-28.5-102, C.R.S.2004, provides:

> (1) There is levied and shall be collected a tax upon the sale, use, consumption, handling, or distribution of all tobacco products in this state at the rate of twenty percent of the manufacturer's list price of such tobacco

products. Such tax shall be imposed at the time the distributor:

> (a) Brings, or causes to be brought, into this state from without the state tobacco products for sale;
>
> (b) Makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
>
> (c) Ships or transports tobacco products to retailers in this state to be sold by those retailers.

Section 39-28.5-101(2), C.R.S.2004, defines "distributor" as

> every person who first receives tobacco products in this state, every person who sells tobacco products in this state who is primarily liable for the tobacco products tax on such products, and every person who first sells or offers for sale in this state tobacco products imported into this state from any other state or country.

Section 39-28.5-101(3) defines "manufacturer's list price" as "the invoice price for which a manufacturer or supplier sells a tobacco product to a distributor exclusive of any discount or other reduction."

Summary judgment is appropriate only if the pleadings and supporting documents demonstrate that there is no genuine issue for trial as to any material fact and that the moving party is entitled to judgment as a matter of law. C.R.C.P. 56; *Bedard v. Martin*, 100 P.3d 584 (Colo.App.2004). Here, the parties agree that there is no dispute as to any material fact. We review orders granting summary judgment de novo. *Harding v. Heritage Health Prods. Co.*, 98 P.3d 945 (Colo. App. 2004).

I.

It has long been established that the Commerce Clause of the United States Constitution not only grants Congress the

authority to regulate commerce among the several states, but also limits the power of the states to discriminate against interstate commerce. *Riverton Produce Co. v. State*, 871 P.2d 1213 (Colo.1994). This latter limitation on the states is characterized as the "negative" aspect of the Commerce Clause and prohibits "economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Riverton Produce Co. v. State, supra*, 871 P.2d at 1221 (quoting *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74, 108 S.Ct. 1803, 1807, 100 L.Ed.2d 302 (1988)).

Thus, the United States Supreme Court has "characterized the fundamental command of the [Commerce] Clause as being that 'a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State.'" *Assoc. Indus. v. Lohman*, 511 U.S. 641, 647, 114 S.Ct. 1815, 1820, 128 L.Ed.2d 639 (1994)(quoting *Armco Inc. v. Hardesty*, 467 U.S. 638, 642, 104 S.Ct. 2620, 2622, 81 L.Ed.2d 540 (1984)). This aspect of the Commerce Clause is frequently referred to as the "dormant Commerce Clause."

The dormant Commerce Clause does not, however, "immunize" all interstate commerce and its instrumentalities from state taxation. *Gen. Motors Corp. v. City & County of Denver*, 990 P.2d 59 (Colo.1999). "[A] state tax is not *per se* invalid because it burdens interstate commerce since interstate commerce may constitutionally be made to pay its way." *Maryland v. Louisiana*, 451 U.S. 725, 754, 101 S.Ct. 2114, 2133, 68 L.Ed.2d 576 (1981); *see also Riverton Produce Co. v. State, supra; Archer Daniels Midland Co. v. Colorado*, 690 P.2d 177 (1984).

A state's right to tax interstate commerce is limited, however, and no tax will be sustained unless it satisfies the four-part test announced by the Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51

L.Ed.2d 326 (1977). *Riverton Produce Co. v. State, supra.* Under *Complete Auto*, a state tax that impacts interstate commerce does not violate the dormant Commerce Clause if: (1) the tax is applied to an activity with a substantial nexus with the taxing state; (2) it is fairly apportioned; (3) it does not discriminate against interstate commerce; and (4) it is fairly related to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady, supra; Riverton Produce Co. v. State, supra; Talbots, Inc. v. Schwartzberg*, 928 P.2d 822 (Colo.App.1996).

Here, McLane alleges that the OTP tax statute violates the third prong of the *Complete Auto* test, that is, it discriminates against interstate commerce. McLane argues that, because each layer in the distribution network marks up the price, the tax imposed on the product will be higher the later in that distribution network that one or more of the triggering events listed in § 39-28.5-102 occurs. Thus, the tax-liable distributor must pay the tax on the larger "tax base" created by the collective price mark-ups. There is no dispute that the tax rate remains constant.

For example, if the manufacturer and all the distributors were located within Colorado, the tax base would be at its lowest level. Thus, as McLane argues, and we agree, the location of the manufacturers, suppliers, or distributors involved in the product's distribution network and the price mark-up of each impacts the tax base or the price upon which the constant twenty percent tax rate is imposed. Consequently, McLane asserts, the OTP tax scheme discriminates against interstate commerce by creating an "inexorable pressure" on out-of-state businesses to move into the state to "take advantage of the overall OTP tax benefit." While we agree with McLane's assertions that the tax base will be higher the later in the distribution network the product is taxed, we disagree with McLane's conclusion that this fact renders the tax unconstitutional under the Commerce Clause.

A state tax violates the third prong of the *Complete Auto* test if it is facially discriminatory, has a discriminatory purpose, or has the effect of unduly burdening interstate commerce. *Riverton Produce Co. v. State, supra.* Although McLane argues in this instance that the OTP tax is discriminatory on its face, we conclude that it neither facially discriminates nor has the effect of discriminating against out-of-state competitors.

Our research, and our review of the authorities cited to us, leads us to conclude that a tax is discriminatory if it taxes out-of-state transactions or entities at a rate higher than it taxes in-state transactions, entities, or products, or if it exempts in-state transactions, entities, or products from an otherwise uniform tax. *See generally Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996) (tax on a fraction of the value of corporate stock inversely related to the exposure of the corporation to state income tax is unconstitutional); *Assoc. Indus. v. Lohman, supra* (additional state use tax imposed on goods purchased out-of-state discriminates against interstate commerce in those counties in which local sales tax rates are less than the additional state use tax); *Ore. Waste Sys., Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994) (difference in rate of surcharge on in-state and out-of-state waste is unconstitutional); *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin.*, 505 U.S. 71, 112 S.Ct. 2365, 120 L.Ed.2d 59 (1992) (corporate income tax that taxed dividends from foreign subsidiaries but allowed deduction for dividends from domestic subsidiaries without a credit for taxes paid to foreign countries is unconstitutional under the Foreign Commerce Clause, U.S. Const. art. I, § 8); *Am. Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 107 S.Ct. 2829, 97 L.Ed.2d 226 (1987) (flat axle tax discriminated against out-of-state truckers because the cost per mile exceeded that of in-state truckers); *Armco Inc. v. Hardesty, supra* (gross receipts tax imposed on businesses selling tangible property at wholesale

is unconstitutional because of exemption granted to in-state manufacturers); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 104 S.Ct. 1856, 80 L.Ed.2d 388 (1984) (franchise tax credit lowering the effective tax rate for products shipped from a regular in-state place of business is unconstitutional); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984) (tax on wholesale sales of liquor that exempted locally produced beverage is unconstitutional); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 97 S.Ct. 599, 50 L.Ed.2d 514 (1977) (stock transfer tax that imposed different tax rates and ceilings depending on residence of seller or place of sale is unconstitutional); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 83 S.Ct. 1201, 10 L.Ed.2d 202 (1963) (use tax on custom-made equipment manufactured out-of-state that included cost of labor and shop overhead in value taxed but excluded labor and shop overhead incurred in manufacturing such equipment in-state is unconstitutional); *see also* 1 Lawrence H. Tribe, *American Constitutional Law* § 6-15 (3d ed.2000) (discussing the implications of many of the cases cited).

In our view, while the tax here is imposed based on the price paid by the taxable distributor, neither Manufacturing or Sales is encouraged to move into the state because they might well become the taxable distributor. The tax is imposed on an activity within the state, the sale and distribution of OTP, not on the product or the distribution network. The fact that the tax base calculated on the price paid by the taxable distributor may place the product at a competitive disadvantage in the marketplace because the higher tax is added to the price does not, in our view, render the tax unconstitutional under the Commerce Clause. All taxable distributors of OTP are taxed at the same rate and on a tax base determined in the same fashion.

McLane's reliance on a line of United States Supreme Court cases finding violations of the Commerce Clause is not

persuasive. McLane cites *Armco Inc. v. Hardesty, supra*, where the state imposed a gross receipts tax on businesses selling tangible property at wholesale in the state, but exempted local manufacturers from paying the tax. Thus, the state gave local businesses a direct tax benefit that it did not give to out-of-state competitors. As the Court noted:

> On its face, the gross receipts tax at issue here appears to have just this [discriminatory] effect. The tax provides that two companies selling tangible property at wholesale in [the state] will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it. Thus, if the property was manufactured in the State, no tax on the sale is imposed. If the property was manufactured out of the State and imported for sale, a tax of 0.27% is imposed on the sale price.

Armco Inc. v. Hardesty, supra, 467 U.S. at 642, 104 S.Ct. at 2622. Because an exemption to an otherwise uniform tax was granted to in-state companies in *Armco*, that case is not persuasive.

Likewise, in *Halliburton Oil Well Cementing Co. v. Reily, supra*, the taxpayer manufactured or assembled custom oil field equipment in another state. The State of Louisiana imposed a use tax on custom-made equipment manufactured out of, and brought for use into, the state. The value taxed on the out-of-state equipment was the total cost of manufacturing and assembling the equipment, including labor and shop overhead. However, with respect to such equipment manufactured in the state, the value did not include such costs. In addition, second-hand equipment was taxed differently based on whether it was purchased in or out of the state. The Court held the tax unconstitutional because it discriminated against out-of-state businesses and would encourage such businesses to move into the state. *See also Am. Trucking Ass'ns v. Scheiner, supra*, 483 U.S. at 286-87, 107 S.Ct. at 2842.

Here, however, the OTP tax scheme does not pressure out-of-state businesses to move to Colorado. Out-of-state manufacturers or distributors may engage in commerce within Colorado without suffering any burden from which local distributors or manufacturers are exempted.

The remaining cases upon which McLane relies are equally unavailing. None of them involves a determination that a state tax violates the Commerce Clause based on the inequities of a shifting tax base. Rather, they turn on unequal rates of taxation or exemptions from taxation for in-state businesses.

McLane also relies on *United States Tobacco Sales & Marketing Co. v. State, supra*, for the proposition that the price set by Manufacturing establishes the tax base. There, Sales distributed free samples of OTP at promotional events such as rodeos, auto races, and fishing tournaments. The question arose as to whether it should pay the OTP tax and, if so, on what base. Sales argued, as McLane argues here, that the correct tax base was the price it paid to Manufacturing. The trial court ruled that the correct basis was the price at which Sales sold the product to unaffiliated distributors.

The appellate court reversed, concluding that there were genuine issues of material fact as to the fair market value, rejected both parties' positions with respect to that issue, and remanded the matter for trial. We do not read the case as establishing Manufacturing's price as the appropriate tax basis under the circumstances presented here. There, Sales was the taxable distributor within the meaning of the Washington statute, and the tax base under that circumstance might well be the price it paid to Manufacturing.

Other states considering the constitutionality of similar OTP taxation statutes have upheld them under the Commerce Clause. In *Kansas Tobacco-Candy Distributors & Vendors,*

Inc. v. McDonald, 214 Kan. 67, 73, 519 P.2d 1110, 1115 (1974), the court stated:

> We do not see, however, how it can be said that the Tobacco Products Act of 1972 discriminates against firms engaged in an interstate business. The privilege tax applies equally to all distributors engaged in the business of selling or dealing in tobacco products in Kansas—to both resident and nonresident distributors. There is no differentiation between purchases made from Kansas manufacturers and purchases made outside Kansas in interstate commerce. All purchases without discrimination are taxed equally at an equal and constant tax rate of ten percent. The tax is imposed either at the time the tobacco distributor brings tobacco products into the state for sale or at the time a local distributor manufactures or fabricates tobacco products in this state for sale in this state. We find no basis for a charge of discrimination against interstate distributors. Furthermore we find nothing in the record to show that distributors of tobacco products in interstate commerce are in any way unduly burdened by the statutory privilege tax imposed.

Similarly, in *McLane Co. v. Washington State Department of Revenue*, 105 Wash.App. 409, 19 P.3d 1119 (2001), the appellate court found that a similar tax did not violate the Commerce Clause. There, McLane argued that the tax was unconstitutional because it was incurred by merely placing an order. The court disagreed, stating:

> But the tax is not levied on the purchase order. Although the tax is "imposed at the time" a distributor "brings or causes to be brought" tobacco products into Washington for sale under RCW 82.26.020(2), the taxable event is the "sale, use, consumption, handling, or distribution of . . . tobacco products." RCW 82.26.020(1). . . . As the Washington Supreme Court has

> explained, "any wholesaler or any retailer who brings or causes tobacco products to be brought into the state from an out-of-the-state source becomes liable for the tax when such tobacco products are brought into the state." *Galvin v. Tax Comm'n*, 56 Wash.2d 738, 740, 355 P.2d 362 (1960). Thus, the purchase order is not the taxable event and the tax is not upon commerce itself. We hold that the OTP tax is not an unconstitutional tax against interstate commerce.

McLane Co. v. Wash. State Dep't of Revenue, supra, 105 Wash.App. at 414-15, 19 P.3d at 1121.

We also note that unsuccessful challenges to a similar OTP tax have been made in Illinois on state constitutional grounds. *Arangold Corp. v. Zehnder*, 204 Ill.2d 142, 272 Ill.Dec. 600, 787 N.E.2d 786 (2003)(due process and uniformity claims; unspecified federal claims abandoned); *Arangold Corp. v. Zehnder*, 187 Ill.2d 341, 240 Ill.Dec. 710, 718 N.E.2d 191 (1999) (single subject provision of state constitution).

Therefore, we conclude that the tax imposed on OTP pursuant to § 39-28.5-101, et seq., does not violate the Commerce Clause of the United States Constitution.

II.

McLane also argues that the plain language of the term "manufacturer's list price" mandates that the invoice price Sales paid to Manufacturing be the price at which the tax base is set. In so arguing, McLane asserts that the trial court "need not reach the term 'supplier' because the facts established an earlier qualifying sale between a manufacturer and a distributor." Thus, McLane argues, "[t]here simply is no reason to move to the second transaction when the first transaction fixes the tax base."

We disagree with McLane's construction of the statute and agree with the trial court that the presence of the term

"supplier" in the statutory definition of "manufacturer's list price" necessarily imposes the tax on the price McLane paid to Sales. We cannot ignore the plain language of § 39-28.5-101(3). When construing a statute, we must presume the General Assembly meant what it clearly said and did not use language idly. *In re Marriage of Mugge*, 66 P.3d 207 (Colo.App.2003). Here, McLane purchased the OTP from a supplier, not a manufacturer, of the product. Accordingly, the price that McLane paid Sales is the "manufacturer's list price" for purposes of the statute.

Having so concluded, we need not address McLane's remaining arguments.

The judgment is affirmed.

Judge WEBB and Judge GRAHAM concur.

APPENDIX B

DISTRICT COURT
CITY AND COUNTY OF DENVER, COLORADO

[Filed November 7, 2003]

Case Number: 02 CV 5118
(consolidated with 02 CV 5777)
Courtroom 18

MCLANE WESTERN, INC.,

Plaintiff,

v.

DEPARTMENT OF REVENUE OF THE STATE OF COLORADO and M. MICHAEL COOKE as the Executive Director of the Department of Revenue of the State of Colorado,

Defendants.

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

The State of Colorado imposes a 20% excise tax on tobacco products other than cigarettes ("other tobacco products" or "OTP"). C.R.S. § 39-28.5-101 et seq. Plaintiff McLane Western, Inc. is a distributor of other tobacco products and paid the tax for most of the 1990's. McLane brings this suit for refund of its alleged over-payment of tobacco excise taxes, claiming it used an incorrect tax base. The Colorado Department of Revenue denies that any refund is due.

These consolidated cases were set for trial. Prior to trial, the parties agreed that there are no genuine disputes as to the material facts and that the matter could be determined on cross-motions for summary judgment. Therefore the trial was vacated, and a hearing on the cross-motions for summary judgment was held on October 23, 2003.

UNDISPUTED MATERIAL FACTS

I agree that the material facts are not in dispute and that the issue may be decided a matter of law. The material undisputed facts are as follows:

1. McLane buys, resells and ships grocery products including smokeless tobacco products, or OTP, throughout the western United States, including Colorado. McLane currently employs 583 persons in Colorado and owns or operates numerous offices, warehouses and equipment throughout Colorado. McLane's principal place of business in Colorado is located in Longmont.

2. McLane is a distributor of OTP in Colorado under Colorado's OTP statute.

3. U.S. Smokeless Tobacco Company is a wholly-owned subsidiary of UST, Inc., a publicly traded corporation. Prior to 1990, U.S. Smokeless Tobacco Company (then known as United States Tobacco Company) performed all functions relating the manufacture, marketing and sale of its smokeless tobacco products, primarily branded as Skoal and Copenhagen. Until 1990, U.S. Smokeless Tobacco Company marketed and sold the OTP that it had manufactured directly to distributors like McLane. Effective January 1, 1990, U.S. Smokeless Tobacco Company reorganized and formed two wholly-owned subsidiaries, U.S.T. Manufacturing and U.S.T. Sales. Following the reorganization, U.S.T. Manufacturing assumed the tobacco manufacturing functions while U.S.T. Sales separately assumed the tobacco marketing and sales functions. In February 1990, U.S. Smokeless Tobacco Company notified state taxing authorities that the UST companies had reorganized, that U.S.T. Sales was responsible for selling the OTP, that U.S.T. Manufacturing was responsible for manufacturing the OTP and that each subsidiary operated as a separate legal entity. The UST companies announced the reorganization to the general public in their annual report and SEC filings at the same time.

4. For all of the refund periods in dispute, McLane purchased the subject OTP exclusively from U.S.T. Sales. McLane then resold the OTP to its customers. Most of McLane's customers in Colorado are small convenience stores and grocery stores.

5. U.S.T. Manufacturing has been the sole manufacturer of the subject OTP. U.S.T. Manufacturing sells the OTP it manufactures exclusively to U.S.T. Sales for resale and distribution in the United States. U.S.T. Manufacturing does not manufacture any tobacco products in Colorado.

6. Since the 1990 reorganization, U.S.T. Sales has engaged in the business of marketing and selling OTP primarily to other distributors, such as McLane, which then resell the product to retailers. U.S.T. Sales purchases the OTP that it markets and resells exclusively from U.S.T. Manufacturing. U.S.T. Sales has its principal place of business in Greenwich, Connecticut and has approximately thirty employees regularly working throughout Colorado.

7. For all of the refund periods in dispute, U.S.T. Manufacturing manufactured and sold the OTP at issue to U.S.T. Sales exclusively. The prices charged by U.S.T. Manufacturing to U.S.T. Sales from the sale of the OTP did not include any discount or other reduction. U.S.T. Manufacturing invoiced U.S.T. Sales on a monthly basis, and U.S.T. Sales paid these invoices on a quarterly or monthly basis. U.S.T. Manufacturing provides its prices to its customers, including U.S.T. Sales, to McLane and similar second-tier distributors with a legitimate business need for the information, and to state taxing authorities upon request.

8. For all of the refund periods in dispute, U.S.T. Sales charged McLane its distributor's list price, which was higher than U.S.T. Manufacturing's price for a number of reasons, including the cost and added value of the marketing, sales and distribution functions performed by U.S.T. Sales.

9. By way of illustration, on December 26, 1996, U.S.T. Manufacturing charged U.S.T. Sales a price of $145.33 for a 180-can case of "premium" OTP. On that same date, U.S.T. Sales charged McLane $352.80 for the same 180-can case. The details of the OTP products, prices and refunds claimed for the relevant periods are reflected in Exhibit A attached to the Koch affidavit submitted with McLane's motion for summary judgment.

10. For the refund periods in dispute, the total amount charged by U.S.T. Sales to McLane was $95,160,668.50. McLane paid total OTP tax of $19,032,122.70. Had the OTP tax been calculated on the price paid by U.S.T. Sales to U.S.T. Manufacturing, the total OTP tax would have been $8,518,660.25.

11. After accounting for the 3.5% vendor deduction, McLane claims it is due a total refund of $10,163,024.33 plus statutory interest.

12. The general steps of each sale transaction between U.S.T. Sales and McLane were as follows:

- When it received a purchase order from McLane, U.S.T. Sales ordered the OTP requested from U.S.T. Manufacturing. Acting as agent for U.S.T. Sales, U.S.T. Manufacturing then arranged, at U.S.T. Sales' expense, for the OTP to be shipped by common carrier to McLane's warehouse in Colorado.

- On delivery of the OTP to the common carrier at the dock of one of U.S.T. Manufacturing's facilities located outside of Colorado, U.S.T. Manufacturing transferred ownership (including title and risk of loss) of the OTP to U.S.T. Sales. U.S.T. Sales retained ownership (including title and risk of loss) of the OTP during shipment to McLane's warehouse in Longmont, Colorado. U.S.T. Sales also bore the cost of shipping the OTP to McLane.

- When the OTP shipment arrived at McLane's warehouse in Colorado, McLane's employees inspected the shipment. If the OTP was in good condition and the quantity verified, McLane accepted delivery of the shipment.

- Upon McLane's acceptance of delivery at its dock in Colorado, U.S.T. Sales transferred ownership (including title and risk of loss) of the OTP to McLane in Colorado. McLane typically paid U.S.T. Sales within seven days of the date of invoice.

13. From March 1990 through September 1993 and March 1996 through December 1997, McLane calculated and paid the OTP excise tax based on the price it paid to U.S.T. Sales. On April 2 and 13, 1999, McLane submitted claims to the Department seeking a refund based on recalculating the tax on the price paid by U.S.T. Sales to U.S.T. Manufacturing. On October 14, 1999, the Department denied McLane's claims for refund. These refund claims are the subject of Civil Action No. 02-CV-5118.

14. On April 19 and June 14, 2002, McLane submitted supplemental refund claims for the periods January 1998 through March 1999 and April 1999 through December 2001. The Department denied McLane's supplemental claims on June 18 and July 23, 2002. These refund claims are the subject of Civil Action No. 02-CV-5777.

15. On November 22, 2002, this Court consolidated the two actions.

THE STATUTORY SCHEME

The excise tax on other tobacco products is levied by C.R.S. §39-28.5-102 which provides as follows:

Tax levied. (1) There is levied and shall be collected a tax upon the sale, use, consumption, handling, or distribution of all tobacco products in this state at the rate of twenty percent

of the manufacturer's list price of such tobacco products. Such tax shall be imposed at the time the distributor:

> (a) Brings, or causes to be brought, into this state from without the state tobacco products for sale;
>
> (b) Makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
>
> (c) Ships or transports tobacco products to retailers in this state to be sold by those retailers.

"Distributor" is defined by the statute as "every person who first receives tobacco products in this state, every person who sells tobacco products in this state who is primarily liable for the tobacco products tax on such products, and every person who first sells or offers for sale in this state tobacco products imported into this state from any other state or country." C.R.S. §39-28.5-101(2).

"Manufacturer's list price" is defined as "the invoice price for which a manufacturer or supplier sells a tobacco product to a distributor exclusive of any discount or other reduction." C.R.S. §39-28.5-101(3).

McLane argues that U.S.T. Sales is a "distributor" under the statute because it first sells tobacco products imported into this state from any other state or country. It is undisputed that the sale from U.S.T. Sales to McLane takes place in Colorado since title does not transfer to McLane from U.S.T. Sales until the product reaches McLane's warehouse in Longmont. Since U.S.T. Sales is a distributor, McLane argues that it should have computed the tax based on the manufacturer's list price paid by U.S.T. Sales to U.S.T. Manufacturing.

The Department initially argued that the statute contemplates there being only one distributor for any given transaction and that McLane, not U.S.T. Sales, was the distributor for the subject transactions. At the hearing, I rejected that reading of the definition of distributor. The Department now

argues that, even if U.S.T. Sales is a distributor, McLane is the distributor liable for the tax and that the appropriate tax base is McLane's price to its supplier, U.S.T. Sales. McLane responds that this interpretation of the statute as applied to these transactions would violate the commerce clause by imposing a burden on interstate commerce.

RULES OF STATUTORY CONSTRUCTION

The rules of statutory construction applicable here are familiar. When a court construes a statute, it must give effect to the intent of the General Assembly. *A.B. Hirschfeld Press v. Denver*, 806 P.2d 917, 920 (Colo. 1991). The words of a statute are to be given "their commonly accepted and understood meaning." *Adams v. Farmers Ins. Group*, 983 P.2d 797, 801 (Colo. 1999). C.R.S. §2-4-101 provides that a statute's "words and phrases shall be read in context and construed according to the rules of grammar and common usage." When interpreting a comprehensive legislative scheme, a court must give meaning to all of the statute's parts and construe them together as a whole. *See, e.g., Huddleston v. Grand County Bd. of Equalization*, 913 P.2d 15, 18 (Colo. 1996).

In the event of a constitutional challenge, a statute is presumed to be constitutional. *Board of County Commissioners v. Vail Associates, Inc.*, 19 P.3d 1263, 1272-1273 (Colo. 2001). The party challenging the constitutionality of a statute has the burden of proving it unconstitutional beyond a reasonable doubt. *Alexander v. Industrial Claims Appeals Office*, 42 P.3d 46, 48 (Colo. App. 2001). If possible, a court must construe a statute in the manner that does not invalidate it. *BQP Indus., Inc. v. State Board of Equalization*, 694 P.2d 337, 343 (Colo. App. 1984).

CONCLUSIONS OF LAW

Having reviewed the briefs and attachments and considered the arguments of counsel and the relevant authorities, and keeping in mind the foregoing rules of statutory construction,

I make the following conclusions of law on the issues presented by the cross-motions for summary judgment.

First, I agree with McLane that U.S.T. Sales fits the definition of "distributor" under the statute. U.S.T. Sales makes the first sale in Colorado of tobacco products imported into this state. The Department's argument that that portion of the definition of distributor should be construed as applying only to products imported into this state to be resold to retailers by the distributor is simply adding additional language to the statute that the legislature did not use. However, I also conclude that U.S.T. Sales, for the purposes of these transactions, is a "supplier" as that term is used in the definition of "manufacturer's list price." The statute does not include any definition of the term "supplier," but supplier is not a technical or obscure term and should be given its common sense meaning. "Supplier" is a noun form of the verb "supply" which means to furnish or provide something. *Webster's College Dictionary* (Random House, 1996). U.S.T. Sales clearly furnishes or provides the OTP to McLane. McLane's argument essentially tries to ignore the presence of "supplier" in the definition of "manufacturer's list price."

The Department argues that since McLane owes the tax, the tax base should be the price McLane pays to its supplier. There seems to be no doubt that McLane owes the tax, and it does not argue to the contrary. The tax is imposed upon the sale, handling or distribution of other tobacco products in Colorado, and McLane performs all three of those incidences of taxation. It is irrelevant, in my view, that U.S.T. Sales might also owe the tax as a seller or distributor of OTP. This case is about what McLane owes, and specifically, the tax base to be used for McLane's payment of the tax.

The three subparagraphs of C.R.S. §39-28.5-102 are called incidences of taxation by the Department and timing of tax payment by McLane. Whatever they are, McLane fits two of those and U.S.T. Sales fits none. McLane fits the category

described in subparagraph (a) because it "brings, or causes to be brought, into this state from without the state tobacco products for sale." The Washington courts have construed this same language in a case involving McLane, although the Washington statute uses the language as one of the statutory definitions of "distributor." In *McLane Company, Inc. v. Washington State Department of Revenue*, 19 P.3d 1119, 1121 (Wash. App. 2001), the Washington Court of Appeals held that McLane was a distributor because it brought or caused to be brought into Washington the tobacco products for resale in Washington. The court rejected McLane's argument that the supplier who owns the products when they arrive in Washington (UST Sales) fits that definition of distributor.

Obviously, McLane also ships or transports tobacco products to retailers in Colorado to be sold by those retailers (subparagraph (b) of §39-28.5-102) while U.S.T. Sales does not. Neither McLane nor U.S.T. Sales makes, manufactures or fabricates tobacco products in Colorado for sale in Colorado (subparagraph (c) of §39-28.5-102). Therefore, the statute contemplates that it is McLane's activities, not the activities of U.S.T. Sales, that trigger payment of the tax.

Given this interpretation of the statute, what tax base does the statute require McLane to use to compute the tax? McLane argues that it should use, not the price it pays, but the price U.S.T. Sales pays to U.S.T. Manufacturing. This argument seems to be premised on reading the definition of "manufacturer's list price" as being restricted to the first sale by *a* manufacturer (UST Manufacturing) to *a* distributor (UST Sales) without regard to who is liable for payment of the tax. Adopting McLane's position would require a strained and unnatural interpretation of the statute. For McLane as a distributor, its "manufacturer's list price" is the price for which its supplier (U.S.T. Sales) sells product to McLane. If the term "supplier" were not in the definition of manufacturer's

list price, McLane's argument that it should use its distributor's purchase price as McLane's tax base would carry weight. However, I cannot ignore the legislature's inclusion of the term "supplier" or its natural application here.

It is a sensible construction of the statute that the price paid by the distributor who owes the tax should be the tax base. This interpretation finds support in C.R.S. §39-28.5-106 which requires that the quarterly returns of the tax must show "the total amount of tobacco products purchased by the distributor during the preceding quarter and the tax due thereon." The return need not reflect the total amount of tobacco products purchased by the distributor's supplier or any other third party. Further, it is unreasonable to expect that a distributor would be required to pay a tax based on a transaction to which it was not a party. Although in this case, U.S.T. Manufacturing apparently makes its list price available to distributors like McLane as well as state taxing authorities, it is certainly possible that a manufacturer of other tobacco products would not readily disclose its price to an unrelated mid-level distributor occupying the position of U.S.T. Sales. McLane has not cited any other excise tax scheme which operates in the unusual manner which McLane proposes here.

For these reasons, I find and conclude that the appropriate tax base is the one used by McLane for ten years, that is, McLane's price paid to U.S.T. Sales. Therefore, McLane is not due any refund.

COMMERCE CLAUSE

McLane argues strenuously that the Department's interpretation of the statute is unconstitutional because it violates the commerce clause. There is no doubt that state taxes which discriminate against interstate commerce by taxing a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the state are constitutionally invalid under the commerce clause. *Associated Indus. of Mo.*

v. Lohman, 511 U.S. 641, 647 (1994). While some earlier interpretations urged by the Department may have suffered from this infirmity, the interpretation I adopt does not. My interpretation of the statute does not depend on where the manufacturer (U.S.T. Manufacturing) or the supplier (U.S.T. Sales) resides or does business or where the sale to McLane takes place. Both U.S.T. Sales and U.S.T. Manufacturing could be located in Colorado or they could both have no contact whatsoever with Colorado. The tax base for McLane would be the same: the price it pays to its supplier. These facts and this interpretation simply do not implicate the commerce clause. McLane posits a variety of hypotheticals that might create problems under the commerce clause. I decline to speculate on how the statute should operate on factual scenarios which are not before me.

Likewise, the foregoing interpretation of the statute does not violate anyone's right to equal protection under the laws; similarly situated distributors will be treated identically.

For all the foregoing reasons, McLane's motion for summary judgment is denied and the Department's cross-motion for summary judgment is granted. McLane's complaints are dismissed with prejudice. Costs are awarded to the Department.

SO ORDERED.

Dated this 7th day of November, 2003.

BY THE COURT:

/s/ Joseph E. Meyer III
JOSEPH E. MEYER III
District Court Judge

cc: Thomas H. Steele, Counsel for Plaintiff
Andrew W. Swain, Counsel for Defendant

APPENDIX C

DISTRICT COURT
CITY AND COUNTY OF DENVER, COLORADO

Case Number: 02 CV 5118
(consolidated with 02 CV 5777)
Courtroom 18

MCLANE WESTERN, INC.,
Plaintiff,

v.

DEPARTMENT OF REVENUE OF THE STATE OF COLORADO and M. MICHAEL COOKE as the Executive Director of the Department of Revenue of the State of Colorado,
Defendants.

ORDER

This matter is before the Court on plaintiff's motion to alter or amend judgment. Defendants have moved to strike that motion as not being consistent with Rule 59, C.R.C.P. The motion to strike is denied. The motion to alter or amend judgment is also denied.

SO ORDERED.

Dated this 9th day of Jan., 2004.

BY THE COURT:

/s/ Joseph E. Meyer III
JOSEPH E. MEYER III
District Court Judge

cc: Thomas H. Steele, Counsel for Plaintiff
Andrew W. Swain, Counsel for Defendant

APPENDIX D

SUPREME COURT, STATE OF COLORADO

[Filed January 9, 2006]

No. 05SC439

MCLANE WESTERN, INC.,

Petitioner,

v.

DEPARTMENT OF REVENUE OF THE STATE OF COLORADO; and M. MICHAEL COOKE, as the Director of the Department of Revenue of the State of Colorado,

Respondents.

ORDER OF COURT

Upon consideration of the Petition for Writ of Certiorari to the Colorado Court of Appeals and after review of the record, briefs, and the judgment of said Court of Appeals,

IT IS THIS DAY ORDERED that said Petition for Writ of Certiorari shall be, and the same hereby is, DENIED.

BY THE COURT, EN BANC, JANUARY 9, 2006.

Copies mailed via the State's Mail Services Division on 01/09/06. MLK

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Clerk of the Court
Colorado Court of Appeals

APPENDIX E

Relevant portions of the Colorado statutes, Sections 101 and 102 of Title 39, Article 28.5, Tax on Tobacco Products of 1986, in effect for all tax periods at issue, provide:

COLORADO REVISED STATUTES
TITLE 39—TAXATION
SPECIFIC TAXES
TOBACCO TAX
ARTICLE 28.5—TAX ON TOBACCO PRODUCTS

39-28.5-101. Definitions

As used in this article, unless the context otherwise requires:

(1) "Department" means the department of revenue.

(2) "Distributor" means every person who first receives tobacco products in this state, every person who sells tobacco products in this state who is primarily liable for the tobacco products tax on such products, and every person who first sells or offers for sale in this state tobacco products imported into this state from any other state or country.

(3) "Manufacturer's list price" means the invoice price for which a manufacturer or supplier sells a tobacco product to a distributor exclusive of any discount or other reduction.

(4) "Sale" means any transfer, exchange, or barter, in any manner or by any means whatsoever, for a consideration, including all sales made by any person. The term includes a gift by a person engaged in the business of selling tobacco products, for advertising, as a means of evading the provisions of this article or for any other purposes whatsoever.

(5) "Tobacco products" means cigars, cheroots, stogies, periques, granulated, plug cut, crimp cut, ready rubbed, and other smoking tobacco, snuff, snuff flour, cavendish, plug and twist tobacco, fine-cut and other chewing tobaccos, shorts,

refuse scraps, clippings, cuttings and sweepings of tobacco, and other kinds and forms of tobacco, prepared in such manner as to be suitable for chewing or for smoking in a pipe or otherwise, or both for chewing and smoking, but does not include cigarettes which are taxed separately pursuant to article 28 of this title.

39-28.5-102. Tax levied

(1) There is levied and shall be collected a tax upon the sale, use, consumption, handling, or distribution of all tobacco products in this state at the rate of twenty percent of the manufacturer's list price of such tobacco products. Such tax shall be imposed at the time the distributor:

(a) Brings, or causes to be brought, into this state from without the state tobacco products for sale;

(b) Makes, manufactures, or fabricates tobacco products in this state for sale in this state; or

(c) Ships or transports tobacco products to retailers in this state to be sold by those retailers.